**Performance Indicator:** Explain types of investments (FI:077)

**OBJECTIVES**

A – Discuss the risks and returns involved with lending investments.

B – Discuss the risks and returns involved with ownership investments.

1-3

**DISCUSSION GUIDE**

**OBJECTIVE A** (Slides 1–3)

(Slide 4)

• So What? Why learn about investments?

A. You may have heard the terms “risk” and “reward” when talking about finance or investing, but did you know that the risk-reward concept is something you experience frequently in your own life?

1. When you ask someone on a date, you’re taking a risk because s/he might say no.

2. However, if you don’t take that risk, you certainly won’t get the reward of her/him   
saying yes!

3. The same concept is true if you’re applying to your dream college—you risk your hopes (and your application fee!), but you might just get accepted.

4. What about skydiving? Jumping from a plane is definitely a risk, but, for many who try it, the reward of exhilaration is more than worth it!

B. Considering how risk and reward play out in your own life can help you understand how these factors affect investors and the types of investments they make.

**DISCUSSION #1:** Ask students how risk and reward play out in their own lives.

(Slide 5)

• Differing attitudes toward risk:

A. If you could do anything you wanted this weekend, what would you do?

1. Race a fast car, ride your skateboard, go bicycling, read a good book?

2. If you’re a risk-taker, you might try something new, such as singing at an “open mic” night.

3. If you’re *not* a risk-taker, you might stick with something more familiar, such as going to see the next film in your favorite series.

B. Willingness to take physical or social risks is determined by your **temperament** (nature) and your attitude.

**DISCUSSION GUIDE** (Obj. A, cont’d)

C. People who face **risk** (the possibility of loss) with a positive attitude are described as   
**risk-tolerant** or risk-takers.

1. Risk-takers know that trying something doesn’t guarantee success.

2. But, they’re willing to “chance it” for the potential **return** (reward or benefit).

3. For a racecar driver, the return is likely the thrill of the experience or of victory.

4. For an investor, the return is what the investment could earn—the additional money s/he could receive.

D. People who face risk with a negative attitude are called **risk-averse**—for them, the potential return is often not worth the uncertainty or the possibility of loss.

**ON THE WEB:** Test your risk-taking attitude by taking CNN’s quiz at <http://edition.cnn.com/2008/BUSINESS/09/26/risk.quiz/index.html?cc=us&selLanguage=en>.

**DISCUSSION #2:** Ask students if they are risk-tolerant or risk-averse.   
What examples can they give to support this?

(Slide 6)

• Investors know they’re taking a risk when they invest.

A. They could lose money.

1. They might not get back more than they’ve put in.

2. They might lose everything they’ve invested.

B. So, why would anyone want to invest?

C. For the earnings, pure and simple.

D. Accepting a level of risk is just part of investing.

DISCUSSION GUIDE (Obj. A, cont’d)

• How do investors know how much risk they can handle?

A. If you’re an investor and want the potential of a high return, you accept a high risk.

B. If you can’t handle a high risk, you select a moderate- or low-risk investment instead—  
with the understanding that taking a lower risk brings you the potential of a lower return,   
in general.

C. Three things tend to determine how much risk you can handle:

1. What you want to accomplish

2. How much time you have to accomplish it

3. Your personality

D. Let’s say your financial goals are to buy a house and to save for your retirement.

1. If you’re in your teens or twenties, preparing for retirement is a long-term goal, while saving for a down payment on a house is something you could do in just a few years.

2. This means that for your retirement investment, you might take a little more risk—because you don’t need the money right away.

3. For your down payment, however, you wouldn’t want to risk what little you have so far—because you’re going to need the money in the near future.

E. Your goals and timetable are not the only determining factors of how much risk you can   
tolerate, however.

1. If you have a personality that is uncomfortable with risk, you might not care how much time is involved.

2. You might be willing to sacrifice the reward you *could* gain in the future for the certainty you have *right now.*

F. Investors who try to avoid risk are mainly interested in protecting their initial investments—and they should be!

1. To “grow” your money, you need to make sure that what you’ve invested will remain safe.

2. Before you choose a specific investment, consider how *likely* it is that you’ll lose what you initially put in.

3. When there’s a good chance you may lose what you’ve invested, the risk is “high.”

4. When there’s a small chance (or no chance) that you’ll lose what you’ve invested,   
the risk is “low.”

5. Higher risks usually bring higher returns.

**ON THE WEB:** For a more in-depth look at investment risk and return, read Ted Schwartz’s column “What Investors Must Know about Risk and Return” at <http://abcnews.go.com/Business/investors-risk-return/story?id=20357473>.

**DISCUSSION GUIDE** (Obj. A, cont’d)

(Slide 7)

• One way to put your investment risk in perspective is to look at the risk pyramid, a graphic way of comparing investments.

A. With high-, moderate-, and low-risk categories, the pyramid helps you to see which   
investments are more or less risky than others.

B. Near the peak are the most risky investments, while at the base are the most reliable   
returns.

C. If an investment you’re considering is located near the middle of the pyramid—but you think you can handle more risk—you might select an investment closer to the peak.

D. If you feel that you can’t afford any large losses right now, you might choose an investment closer to the base.

E. When you visualize how likely it is that you’ll receive a particular return, you can see which selection is the best choice to move you toward your goal.

**DISCUSSION #3:** Show students the risk pyramid graphic and ask them if they recognize any of the investments on it.

(Slide 8)

• Right now, you could select from almost any number of investment opportunities to make your money work for you.

A. These opportunities are called **securities**—the legal lending or owning agreements between individuals, businesses, or governments.

B. Since there are many different types of securities, you might find it helpful to separate them into “lending” and “owning” categories.

C. These categories are sometimes referred to as “debt” and “equity.”

• Investors who can’t handle much risk put their money into lending investments.

A. With a **lending investment,** you allow someone to borrow your money for a period of time—for a price.

B. The extra money you receive provides the motivation for lending.

C. Examples of lending investments are savings accounts, money market accounts, certificates of deposit, and bonds.

DISCUSSION GUIDE (Obj. A, cont’d)

(Slide 9)

• Savings accounts

A. A **savings account** is a lending investment in which you lend money to a bank for the benefit of being able to access it at pretty much any time (you can make up to six withdrawals a month, per federal law).

B. Of course, you can access your money with complete freedom if it’s hidden in your sock drawer.

C. The difference is that you get paid to put your money in a savings account (and you don’t have to worry about your little brother stealing it!)—and that’s what motivates people to do it.

D. Another benefit of a savings account is that you can leave your money in it for an indefinite period of time.

1. This means that you don’t have to move your savings from one place of investment to another.

2. You can keep a savings account open for your entire life.

E. In addition, savings accounts are insured by the **FDIC (Federal Deposit Insurance   
Corporation)** for up to $250,000.

F. No investor has lost a penny in an account insured by the FDIC since its creation in 1933.

(Slide 10)

G. The downside to a savings account is twofold.

1. First, you receive a low rate of return.

a. Right now, savings accounts are returning an average of 0.07 percent interest per year (for updated information, check [http://www.nerdwallet.com/rates/savings-account](http://www.nerdwallet.com/rates/savings-account%20)).

b. This means that if you put $1,000 in your savings account, your investment will earn you less than $1 in interest over an entire year.

**DISCUSSION GUIDE** (Obj. A, cont’d)

2. Second, this low return doesn’t even keep up with inflation—which is a double-whammy.

a. Your savings grows at a slower rate than the cost of goods and services.

b. In effect, your money has less buying power.

**DISCUSSION #4:** Ask students if they have savings accounts. If so, where?   
Do they know what the current rate of return is?

**ON THE WEB:** You can learn more about the pros and cons of putting your   
money in a savings account by visiting <http://finance.zacks.com/advantages-disadvantages-savings-checking-accounts-3843.html> and reading Calia Roberts’ article “Advantages and Disadvantages of Checking and Savings Accounts.”

(Slide 11)

• Money market accounts

A. Another bank account that earns interest is a **money market account**.

B. A money market account is a lending investment that is very similar to a savings account.

C. It’s insured by the FDIC, and you can leave your money in it as long as you’d like.

(Slide 12)

D. However, a money market account may have some additional restrictions.

1. You may be allowed fewer than six withdrawals per month (perhaps only three).

2. Your account may also have a minimum-balance requirement.

**DISCUSSION GUIDE** (Obj. A, cont’d)

E. So, what is the benefit of a money market account over a savings account?

1. Unlike savings accounts, you can write checks from some money market accounts (again, usually a limited number each month).

2. Traditionally, you should get a better interest rate.

3. However, current money market account rates are about the same as savings account rates.

**ON THE WEB:** You can look up money market account rates in your area by   
visiting <http://www.nerdwallet.com/rates/Money-Market-Rates>.

**ON THE WEB:** Learn more about the differences (or lack thereof!) between   
savings accounts and money market accounts by reading Trent Last’s article “Personal Finance 101: Money Market Accounts Versus Normal Savings   
Accounts” at <http://www.thesimpledollar.com/personal-finance-101-money-market-accounts-versus-normal-savings-accounts/>.

**ON THE WEB:** Online banks often offer more attractive interest rates for savings accounts and money market accounts than traditional, “brick-and-mortar” banks do. If you conduct a Google search for “online savings account,” you’ll be able to check out some of the most up-to-date rates.

(Slide 13)

• Certificates of deposit

A. A **certificate of deposit** (CD) is a lending investment in which you lend money to a bank at a set interest rate for a particular period of time.

B. Typical time frames can be as short as 28 days or as long as 10 years.

C. With CDs, you are guaranteed a certain rate of return, but you can’t access your money   
before the end of the time period without paying a penalty.

**DISCUSSION GUIDE** (Obj. A, cont’d)

D. By giving up the right to use your money for a period of time, you can earn a higher return than with a savings or money market account.

E. Good interest rates for five-year CDs are currently around 0.8 percent.

F. To get this interest rate, though, you usually have to invest a minimum amount of money—such as $500 or $1,000.

**ON THE WEB:** Bankrate.com offers further insight on CD investing in a post   
entitled “The Pros and Cons of CD Investing.” You can read it here: <http://www.bankrate.com/finance/cd/the-pros-and-cons-of-cd-investing.aspx>.

(Slide 14)

• Bonds

A. While a CD is offered by a bank, a **bond** is offered by a government, municipality, or   
corporation.

B. A bond is similar to a CD in that it’s a lending investment at a set interest rate for a particular period of time—such as a year, 10 years, or longer.

C. With a bond, however, you don’t pay a penalty if you withdraw the invested amount before the end of the time frame.

D. You just lose the amount you would have received if you’d left it alone.

E. In general, bonds are considered to be *guaranteed* money.

F. They are very low risk.

**DISCUSSION GUIDE** (Obj. A, cont’d)

(Slide 15)

G. The trade-off is that you have to be willing to leave your money with the borrower for the entire time period.

H. In some cases, that’s 30 years!

I. But, the reliability of bonds appeals to many investors who can handle only small amounts of risk.

**ON THE WEB:** A newer trend in bond investing allows investors to positively   
influence society while still getting a return on their investments. Learn more about social impact bonds by watching this video from Goldman Sachs: <http://www.goldmansachs.com/our-thinking/trends-in-our-business/social-impact-bonds.html>.

**DISCUSSION #5:** Ask students if they have ever had a CD or a bond—sometimes, family members will create these lending investments for children when they are born.

**Objective B** (Slide 16)

(Slide 17)

• Investors who are not afraid of risk often put their money into ownership investments—investments that provide owners’ rights in return.

A. Types of ownership investments include stocks, mutual funds, real estate, entrepre-  
neurship/business opportunities, and collectibles.

B. Each ownership investment provides an opportunity for a return by letting you own   
something of significance.

(Slide 18)

• Stocks

A. A **stock** (or share) is a piece of paper—whether real or virtual—that says you own part of a corporation.

B. As an owner (or shareholder), you have the rights and responsibilities of ownership.

C. This means you can attend shareholders’ meetings, vote for issues you support, and receive a portion of the company’s earnings.

D. In addition, you may be able to sell your stocks for a profit, making a sizeable sum of   
money.

**DISCUSSION GUIDE** (Obj. B, cont’d)

(Slide 19)

E. But, being an owner also means you risk losing money.

F. If your stocks decrease in value, you can lose a lot.

G. If the corporation goes out of business, you can lose your whole investment—because, as an owner, you’re part of the corporation. (Since bond holders are *not* owners, they will get paid back before you.)

H. But, even if the corporation *doesn’t* go out of business, you can lose everything you’ve   
invested just due to the up-and-down nature of stock values.

**ON THE WEB:** There are many different kinds of stocks. If you’re interested in learning more about them, check out the article here: <http://www.investopedia.com/university/stocks/stocks2.asp>.

**DISCUSSION #6:** Ask students to name any “good stocks” they’ve heard of.

(Slide 20)

• Mutual funds

A. If you’re concerned about the risks of owning stocks, you could invest in a stock mutual fund.

B. A **stock mutual fund** is a combination of stocks from different corporations or agencies, usually from different industries.

C. The idea behind mutual funds is that you don’t take as much of a risk as you do when you buy individual stocks—but, as an owner, you still have a good chance of receiving a return.

D. How much you receive usually depends on how much risk you’re willing to take.

E. If you buy a combination with more risk, you might get a greater return.

F. One benefit of investing in mutual funds is access to the expertise of the fund’s manager.

1. The manager is directly responsible for deciding which investments best meet the   
mutual fund’s stated purpose.

(Slide 21)

2. Fund managers can make mistakes, though, so you should pay attention to who’s in charge of directing your fund.

**DISCUSSION GUIDE** (Obj. B, cont’d)

G. You should also find out about any fees associated with a mutual fund.

H. Fees vary dramatically and can have a negative impact on your return.

**ON THE WEB:** For a more in-depth look at the advantages of mutual fund investing, read Austin Pryor’s article “20 Major Advantages of Investing in Mutual Funds” at <http://www.crown.org/Articles/tabid/107/entryid/167/Default.aspx>.

(Slide 22)

• Real estate

A. Another ownership investment is **real estate.**

B. You can buy a home to live in, a vacation spot for the summer, an investment property   
that will bring in rent money, or land that might be developed sometime in the future.

C. There are a lot of choices, but the one almost everyone can participate in is home   
ownership.

D. When you buy a home, you pay a certain amount toward the value of the house.

E. While you’re living there, the home’s value can increase along with the property values around you.

F. This means that for the amount of money you invest, you are likely to get more out of the real estate than you pay for it.

G. With property values, your day-to-day risk is **depreciation**, the loss of value due to market forces.

H. This means that if others see your property as less valuable, your real estate is not worth as much.

I. When other properties around yours decrease in value—because they’re run-down or flood-prone—you suffer, too.

**ON THE WEB:** Ian Woychuk explores the ups and downs of investing in real   
estate in his Investopedia article “Exploring Real Estate Investments: Advantages and Disadvantages.” You can find it here: <http://www.investopedia.com/university/real_estate/real_estate4.asp>.

**DISCUSSION #7:** Ask students what types of real estate they might like to own someday.

**DISCUSSION GUIDE** (Obj. B, cont’d)

(Slide 23)

• Entrepreneurship/Business ownership

A. You might not realize it, but the money it takes to start and run a business is an investment.

B. **Entrepreneurship** is one of the riskiest and hardest investments a person can make.

C. That’s because it involves a lot more than just money.

D. Entrepreneurs invest their time, their hard work, their ideas, and their hopes and dreams.

E. When a business fails, the entrepreneur loses a lot.

F. However, entrepreneurship carries the potential of a very high return.

G. Think of Bill Gates of Microsoft, Larry Page of Google, or Mark Zuckerberg of Facebook.

**DISCUSSION #8:** Ask students if they can name any more successful   
entrepreneurs.

(Slide 24)

• Collectibles

A. **Collectibles** are items that gain or lose value over time.

B. Example:

1. You buy a baseball card when it’s not too expensive, and you wait for it to become really valuable.

2. Once it’s worth a lot more than you paid for it, you sell it to someone else to make a profit.

3. Sounds easy, doesn’t it?

**DISCUSSION GUIDE** (Obj. B, cont’d)

(Slide 25)

C. Getting a good return from a collectible, though, depends on two key things.

1. You have to be sure that the item is important to other people, not just you.

2. And, you have to be sure that the item will be *more* important to other people   
*in the future*.

3. It’s impossible to be absolutely certain of either one of these two things.

4. That’s what makes a collectible item a risky investment.

5. You might not be able to sell the item at all—let alone for more money than you’ve   
paid for it.

6. Even so, many people enjoy investing in collectibles such as antiques, gems, stamps, dolls, or sports memorabilia.

7. When investors *like* to collect these items, you figure that they probably don’t mind keeping some of the things they can’t sell.

**ON THE WEB:** Interested in investing in collectibles? Check out the   
MoneyTalksNews article and video at [http://www.moneytalksnews.com/  
2013/08/14/are-grandmas-collectibles-worth-anything/](http://www.moneytalksnews.com/2013/08/14/are-grandmas-collectibles-worth-anything/) to get some helpful hints and suggestions for making money off old comic books, vinyl records, and other random items in your attic.

(Slide 26)

• Individuals aren’t the only ones who make investments. Businesses and other organizations do as well.

A. They want to grow their wealth just as individuals do.

B. Most businesses’ main form of investment is investing back into the company itself—researching and developing new products, purchasing the latest and most efficient   
technologies, expanding into new markets, etc.

**DISCUSSION GUIDE** (Obj. B, cont’d)

C. However, businesses also participate in other forms of investing—they may put cash into savings or money market accounts, purchase bonds or stocks, or buy real estate.

D. Sometimes, businesses invest money that isn’t their own.

1. A common example is a non-profit organization’s **endowment fund**.

2. Funds obtained from donors are pooled together and invested to create additional   
income.

3. A great number of colleges and universities have endowment funds.

**ON THE WEB:** You can learn a bit more by reading Albert Phung’s article   
“How Do University Endowments Work?” at <http://www.investopedia.com/ask/answers/06/universityendowment.asp>.

(Slide 27)

• Make It Pay

A. Do you consider yourself risk-tolerant or risk-averse?

B. What examples can you give to support your claim?

C. How do you think your age, personality, and goals will affect your future as an investor?

(Slide 28)

• The Gray Zone

A. “Heavy” industries such as energy and manufacturing have been known to cause   
environmental damage (pollution, deforestation, etc.).

B. Investing in these industries, however, may bring an investor a good rate of return.

C. It’s certainly not illegal to invest in these types of companies, but is it ethical, considering their negative impact on the environment?

D. What do you think?